

**UNITED STATES BANKRUPTCY COURT  
MIDDLE DISTRICT OF ALABAMA**

In re

Case No. 03-32063-WRS

Chapter 7

TERRY MANUFACTURING  
COMPANY INC.,

Debtor

**MEMORANDUM DECISION**

This Chapter 7 bankruptcy case came before the Court for hearing on the Trustee's Motion for Authority to enter into Joint Prosecution Agreement. (Doc. 927). HLC Industries has filed an objection. (Doc. 938). The Court heard the matter on May 24, 2005. The Trustee was present in person and by counsel Brent B. Barriere. HLC Industries was present by counsel Robert L. Shields, III and Michael L. Temin. The Bankruptcy Administrator was present by counsel Michael Fritz. For the reasons set forth below, the motion is DENIED.

**I. FACTS**

This bankruptcy case began when the Debtor filed a petition in bankruptcy under Chapter 11 on July 7, 2003. On July 10, 2003, the Court appointed J. Lester Alexander as Trustee. (Doc. 20). On April 16, 2004, the Trustee moved to employ Phelps Dunbar as counsel. (Doc. 526). On May 13, 2004, this case was converted to a case under Chapter 7. (Docs. 579, 580). On July 20, 2004, the Court approved the employment of Phelps Dunbar. (Doc. 660).

The application to employ Phelps Dunbar was cast in terms of 11 U.S.C. § 327(e).<sup>1</sup>

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<sup>1</sup> A trustee may employ an attorney under either Section 327(a) or 327(e). Employment is made under 327(a) when the attorney "assists the trustee in carrying out the trustee's duties." Section 327(e) is used to where representation is for a "specified special purpose." This provision is normally used when a lawyer is employed to handle a lawsuit or a discrete matter,

While there were two objections to the employment of Phelps Dunbar (Docs. 555, 565), it does not appear that the question of whether employment should be made under § 327(e) or § 327(a) was raised. Since Phelps Dunbar was employed, they have undertaken to represent the Trustee in several dozen suits. While it may have been contemplated, at the time Phelps Dunbar was first employed, that its employment would be for a “specified special purpose,” since that time, Phelps Dunbar has become heavily involved in virtually all aspects of the Trustee’s activities in this case. Therefore, from this time forward, the Court will consider Phelps Dunbar to be employed pursuant to § 327(a), notwithstanding the contrary language in the original application. Given the breadth of matters handled by Phelps Dunbar, it would not be appropriate to consider their employment to be only for a “specified special purpose.”

In the instant application, the Trustee seeks approval of a joint prosecution agreement with Actrade Liquidation Trust. (Doc. 927). Before considering the specifics of this proposed agreement, we should first review some case history. On August 2, 2004, the Trustee, by Phelps Dunbar, brought an adversary proceeding against HLC Industries under Adversary Proceeding Number 04-3068. The Trustee alleges that HLC received more than \$900,000 in payments which are avoidable pursuant to 11 U.S.C. § 547.

HLC Industries was a supplier for Terry Manufacturing. HLC would provide materials to Terry and issue an invoice. It appears that some of those invoices were factored to Actrade. That is, HLC would ship goods to Terry and then submit an invoice to Actrade for immediate credit.

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where the lawyer had some involvement prior to the filing of the petition. The requirement of “disinterestedness” is different in the two sections. A lawyer may be employed under Section 327(e) so long as he is disinterested with respect to the matter at hand, whereas employment under Section 327(a) requires that the lawyer be disinterested with respect to the estate, which is a broader concept.

If and when Terry would pay the invoice, payment would be made to Actrade rather than HLC. Therefore, a three-party rather than a two-party transaction took place. To further complicate matters, Actrade alleges that HLC altered certain invoices, backdating them so as to make them eligible for factoring. Actrade has brought an Adversary Proceeding against HLC under Adversary Proceeding 05-3031 alleging fraud and breach of contract.<sup>2</sup>

## **II. DISCUSSION**

While the instant motion is cast in the form of a motion seeking approval of a joint prosecution agreement, it would appear to be more akin to a modification of the conditions under which Phelps Dunbar is employed. At the time a professional is employed, it is required to make disclosures of all connections to parties who may have an interest in the bankruptcy case. Rule 2014, Fed. R. Bankr. P.

The instant motion is governed by the provisions of 11 U.S.C. § 327(a) and (c), which provides as follows:

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

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(c) In a case under chapter 7, 12 or 11 of this title, a person is not

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<sup>2</sup> This Adversary Proceeding was filed in advance of the Court's consideration of the Joint Prosecution Agreement. As that agreement is not approved, the Court will, by way of a separate order, dismiss that Adversary Proceeding without prejudice.

disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.

The language of § 327(c) is mandatory. "The court shall disapprove such employment if there is an actual conflict of interest."

Pursuant to this Court's consideration of its record, and the representations of counsel for the parties, it would appear that the respective interests are as follows. First, the Trustee seeks to maximize the estate's recovery under his avoidance powers, including the Adversary Proceeding brought against HLC. Second, the Trustee seeks to minimize the amount of claims allowed against the estate. Actrade, on the other hand, seeks to maximize the amount it receives on the HLC invoices that it has factored. Actrade, it would seem, would be indifferent as to whether it gets paid by HLC or the estate. Examination of the relationship between Terry, HLC and Actrade indicates that their interests are necessarily in opposition to one another.

The Trustee argues that the estate's interests and those of Actrade are aligned. To the extent that Actrade recovers from HLC on its fraud claim, the amount of the indebtedness owed by the estate to Actrade would be reduced. HLC argues, on the other hand, that from the estate's point of view, the matter is a wash. For every dollar recovered by Actrade, thereby reducing the claim of Actrade, the claim of HLC would be correspondingly increased. Based upon the version of the facts provided the Court by the Trustee, it would appear that the amount owed by the estate on the invoices from HLC would be a constant, the only variable would be whether the amount of any given invoice was payable to Actrade or HLC. The Trustee's claim, to be sure, is not

wholly implausible, but it necessarily rests upon the assumption that he has accurate information. It may well be that representatives of Terry as well as those of HLC are involved in fraud.

In its reply memorandum, the Trustee argues that the Actrade Liquidation Trustee “is an innocent victim of the scheme by which HLC invoices were altered. To reflect a new issuance date.” The Trustee’s assertion is based upon the assumption that his information is correct. Yet, this case, more so than any other in memory, is fraught with allegations of wrongdoing. The estate has spent hundreds of thousands of dollars for forensic accounting to reconstruct the books and records of the Debtors.<sup>3</sup> Representations have been made on repeated occasions that this is necessary because the books and records of the Debtors are incomplete and inaccurate. Moreover, the Trustee has filed a massive civil action against 10 named defendants, including Cintas Corporation, Roy Terry and Rudolph Terry, alleging that they systematically looted the Debtor corporations.<sup>4</sup> The Trustee has also alleged wrongdoing on the part of at least one of the Debtors’ banks (Adversary Proceeding 04-3061), and on the part of a former lawyer. (Adversary

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<sup>3</sup> On December 4, 2003, the Court awarded AEA Group compensation in the amount of \$314,467.31. On May 19, 2004, the Court awarded an additional \$174,061.69. On July 21, 2004, the Court awarded an additional \$53,076.75. (Docs. 613, 664).

<sup>4</sup> That civil action was commenced in the Circuit Court for Randolph County, Alabama under Case No. CV-2004-162. Several named defendants removed the case to this Court. On April 15, 2005, this Court remanded the civil action to Randolph County. See, J. Lester Alexander, III v. Cintas Corporation, et. al., Adversary Proceeding 04-3132, Order of Remand entered April 15, 2005. (Adv. Pro. 04-3132, Docs. 28, 29).

Proceeding 04-3135). In this vast sea of alleged wrongdoing, the Court does not share the Trustee's optimism he has located an island of reliable fact upon which he can moor his case.

Even if the argument advanced by the Trustee is valid, based upon the facts presently known (or believed to be known), there is nevertheless an insurmountable problem here. If there has been one overriding theme to these bankruptcy proceedings, it is that the former principals of the Debtor corporations are not reliable and that records and documents created by them cannot be accepted at face value. Indeed, one of the Terrys is in Federal prison and allegations of wrongdoing have been made, by a variety of parties including the Trustee, on the part of the entire management team of the Debtor. To base a finding that the interests of the Trustee and Actrade are aligned upon the facts as presently known is unacceptable. It may very well be that the interests of the estate, Actrade and HLC are all in opposition to one another.

The Court is aware that the motives of HLC in making its objection to the joint prosecution agreement are not pure. Indeed, outside of the sometimes unrealistic world of the Bankruptcy Code, two parties with potentially antagonistic interests will throw in together to fight a common enemy. Indeed, the Alabama Rules of Professional Conduct specifically permit lawyers to represent parties in such situations. See, Rule 1.7(a), Alabama Rules of Professional Conduct. The problem is that in the situation involving a bankruptcy estate where there is no client who can properly evaluate a conflict and determine whether it is in his best interests to waive the conflict and proceed with one lawyer or decline to waive the conflict and proceed with separate counsel. The only persons who truly know the facts have no incentive to cooperate with the Trustee. While the Court does not question that the Trustee has probably made the best decision based upon the information at hand, his contention that the estate's interests are aligned

with Actrade and against HLC, is not adequately supported. As the Court finds that there is an actual conflict of interest between the estate and Actrade, the joint prosecution agreement is not approved.

The following consequences flow from the Court's finding of an actual conflict of interest. First, the motion to approve the joint prosecution agreement (Doc. 927) is DENIED. Second, the motion of Actrade to intervene in Adversary Proceeding 04-3068 is DENIED. (Adv. Pro. 04-3068, Doc. 27). Third, Adversary Proceeding 05-3031 is DISMISSED, WITHOUT PREJUDICE.

### **III. CONCLUSION**

The motion to approve the joint prosecution agreement will be treated as one to amend the conditions of employment for Phelps Dunbar. This application is governed by the provisions of 11 U.S.C. § 327(a) and (c). As HLC is a creditor, and as they object, the Court must deny the instant application as it finds that there is an actual conflict of interest between the estate and Actrade. The Court further finds that it must deny the application, even if it accepts as true, the Trustee's claim that it would be in the best interests of the estate to waive any conflict of interest. The Court will enter separate orders in accordance with Rule 9021, Fed. R. Bankr. P.

Done this 2nd day of June, 2005.

/s/ William R. Sawyer  
United States Bankruptcy Judge

c: Brent B. Barriere, Attorney for Trustee  
Robert L. Shields III, Attorney for HLC Industries  
Michael L. Temin, Attorney for HLC Industries  
Teresa R. Jacobs, Bankruptcy Administrator